FILE COPY

No. 379

In the Supreme Court of the United States

October Term, 1935

GUY T. HELVERING, Commissioner of Internal Revenue, Petitioner,

vs.

SAN JOAQUIN FRUIT & INVESTMENT COMPANY.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Ninth Circuit entered in the above-entitled cause on May 20, 1935.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 253–279) is reported in 28 B. T. A. 395. The opinion of the Circuit Court of Appeals is reported in 77 F. (2d) 723.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered May 20, 1935. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

A lease of real estate with option to purchase was given, and later the option was exercised. Was the property acquired, under the provisions of the Revenue Acts relating to gain or loss, when the option to purchase was given, or when the option was exercised and the property transferred?

STATUTES INVOLVED

The pertinent statutes involved will be found in the Appendix, *infra,* pp. 8–9.

STATEMENT

The facts, as found by the Board of Tax Appeals in its opinion (R. 253–279), may be summarized as follows:

On October 13, 1906, the Irvine Company leased to the San Joaquin Fruit Company 1,000 acres of bare land in Orange County, California, for ten years beginning December 1, 1906. By the terms of the lease, the lessee was required to plant fruit trees on the land and develop a water supply therefor; the lessor was to receive as rent one-fourth of the crops produced on the leased premises. The

lessee was given an option to purchase at $200 per acre not in excess of 500 acres of the land before the expiration date of the lease, or to purchase at the expiration of the lease all of the 1,000 acres at the same price per acre. An exercise of the right to purchase portions of the tract during the life of the lease worked a termination of the option to purchase all of the tract on the expiration of the term of the lease. The lessee could not assign or transfer the lease, or sublet any portion of the land, without the written consent of the lessor. The lessee developed the land as required, and on November 30, 1916, exercised the option given in the lease to purchase the 1,000 acres (R. 261–262).

In 1922, the San Joaquin Fruit Company was reorganized as the San Joaquin Fruit and Investment Company, the respondent, and all of the property was transferred to it (R. 262–264; 273–274).

During the years 1920 to 1928, respondent sold various tracts of the property. In considering respondent's tax liability for these years, the Commissioner determined that the property was acquired on November 30, 1916, when the option was exercised, and that the cost was the $200,000 paid at that time for the land, plus the amounts paid for improvements under the lease agreement, and that this cost figure was the basis for ascertaining gain or loss. The Commissioner's cost figure was not disputed (R. 275).

The Board of Tax Appeals approved the Commissioner's determination. The Circuit Court of Appeals reversed the decision of the Board, holding that the property was acquired in 1906 when the option was given, and that therefore the basis for determining gain or loss was the March 1, 1913, value of the property.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the property was acquired when the option was given, and not when the property was paid for and the title transferred.

2. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision below conflicts in principle with *Commissioner* v. *Cummings,* 77 F. (2d) 670 (C. C. A. 5th) and *Chisholm* v. *Commissioner* (C. C. A. 2d), decided July 8, 1935, not yet officially reported but found in C. C. H. 1935, Vol. 3–A, Par. 9493. These decisions hold that when property is acquired through an option, the property is not acquired or purchased until the option is exercised and the title to the property transferred. In the *Cummings* case this principle was applied in determining the date from which securities were held by the taxpayer, for purposes of the capital-gains provisions. The court there held that where stock

was purchased by exercising an option the stock was held from the date of such exercise and not from the date of the acquisition of the option. In the *Chisholm* case, which also involved options on stock, the court held that the date of exercise of the option, not the date of its acquisition or notification of intent to exercise it, constituted the date on which the sale of stock was made.

2. The decision is inconsistent with the holding of this Court in *Lucas* v. *North Texas Co.*, 281 U. S. 11, which, like the case at bar, involved an option to purchase land. In that case the taxpayer in 1916 gave an option to purchase land and was notified in the same year that the option would be exercised; the land was paid for and conveyed to the optionee in 1917. The taxpayer, although on the accrual basis, was held not entitled to attribute to 1916 the gain on the sale of the land, since not until the payment called for by the option was made did the transaction become absolute. If income cannot be attributed by the vendor to the year in which notification of acceptance of the option is given, there is even less basis for determining that the property itself was acquired by the optionee when the option was given.[1]

3. The court below relied upon a decision by the Supreme Court of California, *Smith* v. *Bangham*,

[1] In the case at bar, the uncertainty whether the land would be acquired was increased by the fact that if any portion of the land had been purchased by the optionee before 1916 the option to purchase the entire tract would have terminated, under the provisions of the lease (R. 262).

156 Cal. 359. The opinion in that case contains a statement that the rights of an optionee "relate back" to the time of acquiring the option, so that intervening rights acquired with knowledge of the option must fall when it is exercised. That doctrine has obviously no relevance to the issue of when such property is acquired within the meaning of the revenue acts. The equitable doctrine of "relation back" cannot obscure the fact that when an option is given the optionee has merely the privilege of accepting, by payment, a continuing offer of sale. Until such acceptance the optionee has been held, in various situations, to have no interest or estate in the land. *Richardson* v. *Hardwick,* 106 U. S. 252 (specific performance); *Todd* v. *Citizens Gas Co.,* 46 F. (2d) 855 (C. C. A. 7th), certiorari denied 283 U. S. 852 (rule against perpetuities); *Phenix Insurance Co.* v. *Kerr,* 129 Fed. 723 (C. C. A. 8th) (insurable interest). The option "merely pointed out the mode in which he [the optionee] might acquire an interest, namely, by paying a certain sum of money within a certain time." *Richardson* v. *Hardwick, supra,* at 254.

4. The question presented is important because of the large number of transactions in which options are used, particularly in connection with real estate and securities. The doctrine of "relation back", as it has been applied herein, introduces a novel and fictitious element into the law of income

taxation and will create confusion in numerous tax cases involving the exercise of options.

Wherefore, it is respectfully submitted that this petition should be granted.

STANLEY REED,
Solicitor General.

AUGUST 1935.

APPENDIX

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060:

BASIS FOR DETERMINING GAIN OR LOSS.

SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; * * *.

* * * * *

Revenue Act of 1921, c. 136, 42 Stat. 227, 229:

BASIS FOR DETERMINING GAIN OR LOSS

SEC. 202. (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; * * *.

* * * * *

(b) The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a); but—

(1) If its fair market price or value as of March 1, 1913, is in excess of such basis, the gain to be included in the gross income shall be the excess of the amount realized therefor over such fair market price or value;

* * * * *

Revenue Act of 1924, c. 234, 43 Stat. 253:

BASIS FOR DETERMINING GAIN OR LOSS, DEPLETION, AND DEPRECIATION

SEC. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

(b) The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property * * * or (B) the fair market value of such property as of March 1, 1913, whichever is greater. * * *

* * * * *

(U. S. C., Title 26, Sec. 935).

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